

Physicians are generally subject to the Service Occupation Tax on tangible personal property transferred as an incident to the sale of service. See 86 Ill. Adm. Code 140.101. (This is a GIL).

April 26, 2002

Dear Xxxxx:

This is in response to your letter dated January 21, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200>.

In your letter you stated and made inquiry as follows:

We are writing to inquire as to whether the State of Illinois imposes sales and use or similar taxes on prescription or 'legend' drugs. Specifically, we request the State of Illinois' position on what, if any, parts of the following transactions are subject to tax and the legal authority supporting the position:

1. Purchase of prescription drugs by a physician (defined for purposes of this letter to include any practitioner licensed to prescribe and administer drugs for human treatment) from a pharmaceutical distribution company for use by the physician or those under the physician's supervision in the treatment of *cancer* patients or other patients for a fee when the physician, or a technician operating under the physician's supervision, prepares one or more drugs and/or other compounds for the treatment of a specific patient For example, what is the tax treatment of the purchase of *chemotherapy* drugs, prescription drugs used to relieve the effect of such treatment, and related therapeutic agents administered to cancer patients that are prepared under a physician's supervision to treat a specific patient and are subsequently administered to the patient via injection or intravenously?
2. Purchase of injectible prescription drugs by a physician from a pharmaceutical distribution company for use under the physician's supervision in the treatment of patients for a fee. For example, what is the tax treatment for the purchase of antibiotics that are administered via injection or intravenously?
3. Purchase of prescription drugs by a physician from a pharmaceutical distribution company for resale to patients. For example, what is the tax treatment when a physician purchases oral antibiotics for resale to patients?

4. With respect to the above transactions does it matter:
 - Whether the physician separately states the charge for the drugs?
 - Whether the physician has a licensed or registered pharmacist on staff that dispenses the drugs?
 - Who pays for the treatment (e.g. Medicare, Medicaid, commercial insurer, or individual)?
 - Whether the physician is licensed as a dispensing physician or has a license that allows the physician to dispense medications?
5. Purchase of prescription drugs by a hospital or clinic from a pharmaceutical distribution company for the treatment of patients in the hospital or clinic pursuant to the order of a physician. For example, what would be the tax treatment of the purchase of drugs by a hospital where the drugs are delivered to a central pharmacy and dispensed pursuant to a physician's order and administered by a physician, nurse or other health care professional?
 - With respect to transaction number 5, does it matter if the hospital or clinic is a nonprofit corporation and/or exempt from federal taxation?

We appreciate your willingness to set forth the state's position on these transactions. Your advice will assist our clients in complying with Illinois' sales and use tax laws.

Please mail your reply or fax.

Physicians are primarily engaged in professions that render services. To the extent they are engaged in such professions and are not engaged in the business of selling tangible personal property to purchasers for use or consumption, they are servicemen and are not required to report and remit Retailers' Occupation Tax measured by their receipts from engaging in such professions. This includes receipts from both services and tangible personal property transferred incident to those services. See the enclosed copy of 86 Ill. Adm. Code 130.2020.

Physicians are generally subject to the Service Occupation Tax, however, on tangible personal property transferred as an incident to the sale of service. See the enclosed copy of 86 Ill. Adm. Code 140.101, the Basis and Rate of the Service Occupation Tax. Therefore, when a physician transfers tangible personal property to a patient as a part of the medical treatment rendered to the patient, such as in the case of administering chemotherapy drugs intravenously to cancer patients as a part of their cancer treatment, the physician will be subject to the Service Occupation Tax for that type of transfer, rather than Retailers' Occupation Tax. Please note that if physicians purchase drugs from a pharmaceutical distribution company for resale to patients, separate from a sale of medical service, as in the case of oral antibiotics that the patient will take home and administer himself, for example, the physician is performing a service similar to that of a pharmacist. When that is the case, the physician will also be subject to Service Occupation Tax for that type of transfer, rather than Retailers' Occupation Tax.

The purchase by physicians of tangible personal property that is to be transferred to their patients incident to the sale of service could result in either Service Occupation Tax liability or Use Tax Liability for the physician, depending upon which tax base the physician chooses to calculate his

liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the serviceman's entire bill; (3) Service Occupation Tax on his cost price if he is a registered de minimis serviceman; or (4) Use Tax on his cost price if he is an unregistered de minimis serviceman.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred.

If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sale of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers and remit the tax to the Department by filing returns. They do not pay tax to their suppliers as they provide Certificates of Resale to their suppliers when purchasing the property for transfer to their service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to register under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-state suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. See 86 Ill. Adm. Code 140.109.

You should also be aware that when a physician sells tangible personal property such as medical bracelets, crutches, wheelchairs, first-aid kits and the like for use or consumption apart from their rendering of service as physicians, they incur Retailers' Occupation Tax liability based on the gross receipts from those sales. Physicians selling tangible personal property for use or consumption must be registered as retailers with the Department. See 86 Ill. Adm. Code 130.2020.

Please note that sales of qualifying food, drugs, medicines, and medical appliances, whether sold subject to the Retailers' Occupation Tax or Service Occupation Tax provisions are taxed at the

rate of 1% rather than the usual State rate of 6.25%. See the enclosed copy of 86 Ill. Adm. Code 130.310.

A medicine or drug is defined as any pill, powder, potion, salve, or other preparation intended by the manufacturer for human use and which purports on the label to have medicinal qualities. See Section 130.310(c)(1).

A medical appliance is defined as an item intended by its manufacturer for use in directly substituting for a malfunctioning part of the body. Examples of items that qualify are artificial limbs, dental prostheses, and orthodontic braces, crutches and orthopedic braces, wheelchairs, heart pacemakers, and dialysis machines. Corrective medical appliances such as hearing aids, eyeglasses and contact lenses are also examples of qualifying items. Generally, medical tools, devices and equipment used for diagnostic, rehabilitative and treatment purposes do not qualify for the reduced rate of tax for medical appliances as such items, while being used for the treatment of patients, are not directly substituting for a malfunctioning part of the body. See Section 130.310(c)(2).

Sales made to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active exemption identification number. See 86 Ill. Adm. Code 130.2080(a). This rule applies to all servicemen. While no tax may be due on payments made directly to vendors by Medicare or Medicaid, tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare and Medicaid. This means when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable.

Some health care organizations (e.g. hospitals) that make application to the Department are determined to be exclusively organized and operated for charitable purposes. These organizations receive a tax exemption identification number ("E" number). Organizations that have secured tax exemption identification numbers from the Department are exempt from Use Tax when purchasing tangible personal property for use in furtherance of organizational purposes, and retailers do not incur Retailers' Occupation Tax on such sales. See 86 Ill. Adm. Code 130.2005 and 130.2007, enclosed.

Please note that even tax exempt hospitals and other exclusively charitable organizations incur sales tax liability on certain sales of tangible personal property. See, for example, 86 Ill. Adm. Code 130.2005(b)(1)(A).

Section 130.2005(b)(1) states as follows:

1) Hospital sales

- A) Nonprofit hospitals which qualify as exclusively charitable institutions are not taxable when selling food or medicine to their patients in connection with the furnishing of hospital service to them, nor on the operation of restaurant facilities which are conducted primarily for the benefit of the hospital's employees, and which are not open to the public. However, sales made in a hospital cafeteria which is open to the public will be taxable sales.
- B) In the case of hospitals which qualify as charitable institutions, such hospitals are not taxable when selling drugs to anyone because this is for the relief of the sick (which is the hospital's primary purpose) and so is "primarily for the purpose of" such hospitals, thus qualifying such

transactions for tax exemption. However, a hospital or hospital auxiliary incurs Retailers' Occupation Tax liability when selling candy, chewing gum, tobacco products, razor blades and the like at retail even when such items are sold only to patients because (unlike food and medicine) these items are not necessary to the furnishing of hospital service, and they are competitive.

- C) The same distinctions apply to nonprofit sanatoria and nonprofit nursing homes when they qualify as exclusively charitable institutions.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of 2 Ill. Adm. Code 1200.110(b), which can be obtained from the Department Web site.

Sincerely,

Martha P. Mote
Associate Counsel

MM:msk
Enc.